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No. 93-1662

In the Supreme Court of the United States

OCTOBER TERM, 1994

MOBILE FREEZERS, INC., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether a bankruptcy court may convert a bankruptcy case from a Chapter 11 reorganization to a Chapter 7 liquidation when a debtor sells all of its assets, instead of remaining in business as provided for in the plan of reorganization, and fails to make the payments required under the plan.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-2a) is unpublished, but the decision is noted at 14 F.3d 57 (Table). The order of the district court (Pet. App. 3a-17a) is reported at 146 Bankr. 1000. The order of the bankruptcy court (Pet. App. 18a-26a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on January 20, 1994. The petition for a writ of certiorari was filed on April 20, 1994. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner Mobile Freezers, Inc., a shrimp processing company based in Mobile, Alabama, filed for bankruptcy protection under Chapter 11 of the Bankruptcy Code. Petitioner filed a plan of reorganization under which secured creditors would be paid in full and unsecured creditors would receive 20% of the face value of their claims. Pet. App. 19a-20a, 4a. Under the plan, petitioner was to retain its property and extend its sublease on the processing facility. The plan also provided that, in exchange for a payment of $6,000 in "new capital," petitioner's three equity security holders were to keep their equity holdings and their management positions. Over the objections of several unsecured creditors, including the United States Defense Logistics Agency,[1] the bankruptcy court confirmed petitioner's plan. *Id.* at 4a.

Seven months later, petitioner requested permission from the bankruptcy court to sell the bulk of its assets for $775,000. Pet. App. 20a. Out of the proceeds of the sale, petitioner proposed to pay the secured creditors in full and pay the unsecured creditors 20% of their claims. Since the amount of the sale was considerably more than the liquidation value used in formulating the reorganization plan, over $180,000 would remain after making these payments, which petitioner planned to distribute to its three equity holders. *Id.* at 11a. The United States opposed the motion and moved under 11 U.S.C. 1112(b) to convert petitioner's case from a Chapter 11 reorganiza-

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[1] The Small Business Administration (SBA) had a partially secured claim. Under the plan, the SBA would have received the full amount of the secured portion of its claim and 20% of the unsecured amount. Pet. App. 4a.

tion to a Chapter 7 liquidation on the grounds that petitioner had failed substantially to consummate the plan of reorganization and had materially defaulted with respect to the plan.[2] Pet. App. 6a, 11a.

2. The bankruptcy court concluded that payment of the proceeds of the sale to the creditors would constitute substantial consummation of the plan. Pet. App. 23a. Although the bankruptcy court acknowledged that petitioner "technically did default" by failing to make the payments required under the plan, the court determined that the default was "not 'material'" because petitioner now proposed "to immediately pay the amount of distribution owed to creditors under the confirmed plan." *Ibid.* The bankruptcy court therefore denied the United States' motion for conversion. *Ibid.* The government sought a stay pending appeal, and the proceeds of the sale were placed in escrow pending the outcome of the appeal. *Id.* at 4a.

3. The district court reversed. Pet. App. 3a-17a. The court held that there was "cause," as defined by 11 U.S.C. 1112(b), for converting the case from a reorganization under Chapter 11 to a liquidation under Chapter 7,

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[2] 11 U.S.C. 1112(b) provides in relevant part:

> * * * [O]n request of a party in interest
>
> * * * the court may convert a case under this chapter to a case under chapter 7 of this title or may dismiss a case under this chapter, whichever is in the best interest of creditors and the estate, for cause, including—
>
> * * * * *
>
> (7) inability to effectuate substantial consummation of a confirmed plan;
>
> (8) material default by the debtor with respect to a confirmed plan;
>
> * * * * *

because the plan of reorganization was not substantially consummated, and because the plan was materially breached by the debtor. Pet. App. 6a-11a.

The court noted that the Bankruptcy Code sets forth a three-part test for determining whether a plan has been "substantially consummated." That test requires (1) transfer of substantially all of the property proposed by the plan to be transferred, (2) assumption by the debtor of substantially all of the property dealt with by the plan, and (3) commencement of distribution under the plan. Pet. App. 7a, citing 11 U.S.C. 1101(2). The court concluded that the confirmed plan "is not—and cannot be—substantially consummated," because "[t]he plan in this case called for the debtor to continue operations and retain title to all assets," Pet. App. 10a, whereas petitioner discontinued operations, disposed of its assets and licenses to do business, and failed to make distributions under the plan. *Id.* at 9a.

The court also concluded that the plan had been materially breached because petitioner was not continuing in business as required by the plan, and because the equity holders failed to make the capital contributions required of them under the plan. Pet. App. 10a-11a. The court also noted that the point of Chapter 11 is "to permit a business to continue operating," Pet. App. 11a, and that liquidation is the principal focus of Chapter 7. Pet. App. 11a-12a. By granting the debtor's motion, the district court held, the bankruptcy court had "allow[ed] a liquidation while circumventing the order of priority for the payment of claims established by Chapter 7. It would be unconscionable to commit this windfall to the debtor's benefit at the expense of the creditors. This is an abuse of bankruptcy purposes." *Id.* at 12a.

4. The court of appeals affirmed, agreeing with the district court's finding that "there were one or more

material defaults by the Debtor." Pet. App. 2a. In support of its decision, the court of appeals noted, "the record contains overwhelming evidence of equitable considerations pointing to the result reached by the district court." *Ibid.*

ARGUMENT

Petitioner contends (Pet. 11-19) that the decision below undermines the doctrine of res judicata, because it permits a court to revisit the terms of a plan of reorganization after the plan's confirmation, that there were no material defaults, and that the proceeds of the sale are not part of the bankruptcy "estate." Those contentions do not warrant review by this Court.

1. A bankruptcy court may convert a Chapter 11 bankruptcy case to one under Chapter 7 "for cause," including the "inability to effectuate substantial consummation of a confirmed plan" and a "material default by the debtor with respect to a confirmed plan." 11 U.S.C. 1112(b)(7) and (8). Section 1112(b)'s express grant of authority to convert a proceeding to Chapter 7 following confirmation of a plan refutes petitioner's argument (Pet. 13-15) that principles of res judicata that are embodied in the Bankruptcy Code bar a court from invalidating a confirmed plan of reorganization in the absence of a finding of fraud.[3]

2. The courts below correctly applied Section 1112(b), and properly concluded that the case should be converted to a Chapter 7 liquidation. Pet. App. 2a, 17a. First, the

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[3] Petitioner is also wrong to suggest (Pet. 17) that the plan's confirmation "terminated the bankruptcy proceeding's restraint" on the conduct of petitioner's business. The bankruptcy court's conversion power in 11 U.S.C. 1112(b) clearly contemplates continuing supervision over the debtor's affairs.

plan was not "substantially consummated." Under the Code, "substantial consummation" means:

> (A) transfer of all or substantially all of the property proposed by the plan to be transferred;
>
> (B) assumption by the debtor * * * of all or substantially all of the property dealt with by the plan; and
>
> (C) commencement of distribution under the plan.

11 U.S.C. 1101(2). Petitioner did not meet those requirements. As the district court noted (Pet. App. 10a), the plan that was confirmed in this case contemplated that the debtor would remain in business, not that it would sell all of its property and cease operating its prior business as a going concern. Moreover, it is undisputed that petitioner did not make the distributions required by the plan. Contrary to petitioner's suggestion, the sale of all assets, which directly contradicts the plan, cannot "substantially consummate" the plan. See 11 U.S.C. 1101(2).

The courts below also correctly found that petitioner had materially defaulted on its obligations under the plan. Pet. App. 2a, 10a-11a. Petitioner concedes that its equity holders failed to make the payments required under the plan, but it argues that those defaults are not "material." Pet. 17. As the district court noted (Pet. App. 10a-11a), however, the plan was confirmed only because the equity holders had agreed to make those payments. Ordinarily, equity holders are not allowed to receive anything under a reorganization plan if, as here, dissenting creditors are impaired. See 11 U.S.C. 1129(b)(2)(B). Since the confirmation of the plan hinged on the equity holders' agreement to supply new capital,

the failure to make those payments is clearly material. Moreover, as the district court held, the asset sale "clearly contradict[ed]" (Pet. App. 10a) the basic premise of the reorganization plan—that the debtor would "continue to operate and * * * retain title to all assets"—and that sale therefore also constituted a material breach of the plan.

3. Petitioner's final argument is that the proceeds of the sale are not part of the Chapter 7 estate because the money from the sale of assets was acquired after the plan was confirmed. Pet. 17-18. As petitioner concedes (Pet. 17), the court of appeals did not address that issue. This Court "usually will decline to consider questions presented in a petition for certiorari that have not been considered by the lower court." *Patrick* v. *Burget*, 486 U.S. 94, 99 n.5 (1988); see *INS* v. *Center For Immigrants' Rights*, 112 S. Ct. 551, 555 (1991); *Youakim* v. *Miller*, 425 U.S. 231, 234 (1976). Petitioner offers no reason for departing from that general rule.

In any event, petitioner's argument lacks merit. This is not a case where the debtor acquired new assets after filing for bankruptcy relief. The money at issue represents the proceeds from the sale of the debtor's prepetition assets. Pet. App. 20a. It would be anomalous to conclude, as petitioner suggests (Pet. 17-19), that creditors are not entitled to receive the liquidation price of prepetition assets in a Chapter 7 liquidation proceeding. That is particularly true where, as here, the original valuation of the assets under the plan of reorganization was unrealistically low. See Pet. App. 13a. As the district court concluded, after noting the sizeable discrepancy in the value of the assets used in the plan and the actual sale price, conversion to Chapter 7 is especially appropriate in this case, "[w]here the difference in value is of this magnitude, and where the debtor

certainly has more information on the value of the assets than the creditors, and where a windfall of this magnitude works to the benefit of the debtor and against the creditors." Pet. App. 13a.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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